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REVISED SYSTEM OF NATIONAL ACCOUNTS

CHAPTER VII

THE PRIMARY DISTRIBUTION OF INCOME ACCOUNT

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VII. THE PRIMARY DISTRIBUTION OF INCOME ACCOUNT

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VII. THE PRIMARY DISTRIBUTION OF INCOME ACCOUNT

List of Acronyms

FRA	forward rate agreement
GDP	gross domestic product
GFS	government finance statistics
GNI	gross national income
GNP	gross national product
IMF	International Monetary Fund
NNI	net national income
NPI	non-profit institution
OECD	Organisation for Economic Co-operation and Development
VAT	value added tax

VII. THE PRIMARY DISTRIBUTION OF INCOME ACCOUNT

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VII. THE PRIMARY DISTRIBUTION OF INCOME ACCOUNT

A. Introduction

1. The Primary Distribution of Income Account is shown in table VII.1. It consists of two consecutive accounts, namely the Generation of Income Account and the Allocation of Primary Income Account, shown in tables VII.1 and VII.2, respectively. When appropriate, the latter may be divided into two further sub-accounts, namely the Entrepreneurial Income Account and the Allocation of Other Primary Income Account, as shown in table VII.3.

2. The general purpose of the Primary Distribution of Income Account is to show how primary incomes are distributed among institutional units and sectors. Primary incomes are incomes that accrue to institutional units as a consequence of their involvement in processes of production or ownership of assets that may be needed for purposes of production. They are payable out of the value added created by production. The primary incomes that accrue by lending or renting financial or tangible non-produced assets, including land, to other units for use in production are described as property incomes. All taxes on production and imports are treated as primary incomes of governments even though not all of them are payable out of the value added of enterprises. Primary incomes do not include social contributions and benefits, current taxes on income, wealth, etc. and other current transfers, such current transfers being recorded in the Secondary Distribution of Income Account.

1. The Generation of Income Account

3. The Generation of Income Account is compiled for resident enterprises or groups of resident enterprises: that is, for resident institutional units in their capacities as producers of goods and services. It represents a further extension or elaboration of the Production Account in which the primary incomes accruing to units participating directly in production and to government units are recorded. Like the Production Account, it may be compiled for establishments and industries as well as for institutional units and sectors. The Generation of Income Accounts show the sectors, sub-sectors or industries in which the primary incomes originate, as distinct from the sectors or sub-sectors destined to receive such incomes. For example, the compensation of employees recorded in the Generation of Income Account for the household sector consists of the total compensation of employees payable by unincorporated enterprises owned by households. This item is very different from the total compensation of employees receivable by the household sector that is recorded in the following account, the Allocation of Primary Income Account.

4. The resources, listed on the right side of the Generation of Income Account, consist of only a single item, value added, the balancing item carried forward from the Production Account. As stated in <chapter VI, Production Account>, gross value added is defined as the value of output minus the value of intermediate consumption. Value added may also be measured net:

that is, after deducting the consumption of fixed capital on the fixed assets used in the production process. Consumption of fixed capital is a cost of production that should preferably be deducted from output along with intermediate consumption whenever possible. However, the data available do not always permit satisfactory estimates to be made of consumption of fixed capital, so that provision has to be made in the accounts of the System for value added to be measured gross as well as net. Provision must therefore also be made throughout the remaining accounts of the System for the relevant balancing items to be measured gross or net of consumption of fixed capital. The concept and measurement of consumption of fixed capital has been explained in detail in <chapter VI, Production Account> and will not be discussed further here. For simplicity, it will be assumed here that value added is measured net, except when the context requires gross value added to be referred to explicitly.

5. The left side of the Generation of Income Account records the uses of value added. As property incomes payable by enterprises are recorded in the following account, there are only two main types of charges that producers have to meet out of value added: namely, compensation of employees payable to workers employed in the production process and any taxes, less subsidies, on production payable or receivable as a result of engaging in production. The latter consist of taxes payable or subsidies receivable on goods or services produced as outputs and other taxes or subsidies on production, such as those payable on the labour, machinery, buildings or other assets used in production. Taxes on production do not include any income taxes payable by the recipients of incomes accruing from production, whether employers or employees. Both compensation of employees and taxes on production may be payable by resident producers to non-residents.

6. The content of the item taxes, less subsidies, on production payable out of value added depends upon the way in which output is valued. Firstly, invoiced value added tax (VAT), or any other similar deductible tax, is always excluded from the value of output, and hence from value added. VAT is therefore not payable out of the value added recorded in the Generation of Income Account of an individual institutional unit or sector. Secondly, output may be valued either at basic or at producers' prices. Basic prices exclude all taxes or subsidies on products payable or receivable on outputs, while producers' prices include all such taxes except VAT or similar deductible taxes. When output is valued at basic prices, the only taxes or subsidies on production recorded under uses in the Generation of Income Account are therefore other taxes or subsidies on production, such as those payable or receivable on the machinery, labour, buildings or other assets used in production. When output is valued at producers' prices, this item includes all taxes or subsidies payable or receivable on outputs (except VAT or similar deductible taxes) as well as other taxes or subsidies on production.

7. After deducting compensation of employees and taxes, less subsidies, on production from value added, the balancing item of the Generation of Income Account is obtained, described either as the operating surplus or mixed income depending upon the nature of the enterprise. This balancing item is also

shown on the left side of the account under uses. It measures the surplus or deficit accruing from production before taking account of any interest, rent or similar charges payable on financial or tangible non-produced assets borrowed or rented by the enterprise, or any interest, rent or similar receipts receivable on financial or tangible non-produced assets owned by the enterprise. The balancing item is described as the operating surplus except for unincorporated enterprises owned by households in which the owner(s) or members of the same household may contribute unpaid labour inputs of a similar kind to those that could be provided by paid employees. In the latter case, the balancing item is described as mixed income because it implicitly contains an element of remuneration for work done by the owner, or other members of the household, that cannot be separately identified from the return to the owner as entrepreneur.

8. When the enterprise is a non-market producer owned by a government unit or a non-profit institution (NPI), the output that it provides to other units cannot be valued on the basis of actual or estimated market prices. By convention, such output is valued by its costs of production - intermediate consumption, consumption of fixed capital, compensation of employees plus taxes, less subsidies, on production. No net operating surplus is generated when output is valued in this way by the sum of the values of the inputs. However, the services of government-owned buildings that enter into the intermediate consumption of other government production are valued at their estimated market rentals so that some operating surplus is generated in the production of these services <<see chapter VI, Production Account, paragraph>>. Output valued for own final consumption or own capital formation may also be valued by its costs of production if it is not possible to value it at basic prices.

9. As explained in <chapter VI, Production Account>, all the inputs into, and outputs from, processes of production are valued at the times they are used, or produced, as distinct from the times they were acquired or disposed of. In consequence, output, intermediate consumption and consumption of fixed capital are all defined and valued in such a way as to exclude holding gains on the inventories and fixed assets employed in production. The operating surplus, or mixed income, is therefore a measure of profit that also excludes all holding gains. On the other hand, profits based on historic cost accounting, as often used in business accounts, combine such holding gains with the operating surplus and may therefore be substantially higher than the operating surplus when there is inflation.

10. As noted in <chapter VI, Production Account>, gross domestic product (GDP) at market prices for the total economy consists not only of the sum of the gross values added of all resident enterprises but also all taxes, less subsidies, on products that are not payable on the values of the outputs of those enterprises: that is, all taxes or subsidies on imports plus all non-deductible VAT when output is valued at producers' prices, and all taxes or subsidies on products when output is valued at basic prices. Taxes and subsidies on imports and VAT must therefore also be recorded under uses of GDP in the Generation of Income Account for the total economy, even though they

never appear in the Generation of Income Accounts for individual institutional units or sectors.

2. The Allocation of Primary Income Account

11. The Allocation of Primary Income Account focuses on resident institutional units or sectors in their capacity as recipients of primary incomes rather than as producers whose activities generate primary incomes. It includes the amounts of property incomes receivable and payable by institutional units or sectors. As already noted, the Generation of Income Account, being related to production activities, can be compiled for establishments and industries as well as for institutional units and sectors. However, the Allocation of Primary Income Account has no such direct link with production and can only be compiled for institutional units and sectors.

12. The resources, listed on the right side of the Allocation of Primary Income Account, consist of two main kinds of income. The first is primary incomes of the kind already recorded in the Generation of Income Account. These are the primary incomes receivable by resident institutional units that directly participate in processes of production or by government units through taxing production or imports: namely,

(1) compensation of employees receivable by households;

(2) taxes, less subsidies, on production or imports receivable or payable by government units;

(3) operating surplus, or mixed income, of enterprises carried forward from the Generation of Income Account.

The second kind is the property incomes receivable from the ownership of financial or tangible non-produced assets (mainly land or sub-soil assets). These consist of:

(4) interest, dividends and similar incomes receivable by the owners of financial assets;

(5) rents receivable by owners of land or sub-soil assets leased to other units.

The incomes receivable under headings (1), (2) and (4) include incomes receivable from non-resident institutional units.

13. The uses, listed on the left side of the Allocation of Primary Income Account, consist only of the property incomes payable by institutional units or sectors to creditors, shareholders, landowners, etc. Except for rents on land and sub-soil assets, these may be payable to non-residents as well as residents. The remaining item recorded under uses is the balancing item, the balance of primary incomes, defined as the total value of the primary incomes

receivable by an institutional unit or sector less the total of the primary incomes payable. At the level of the total economy it is described as national income.

14. The composition of the balance of primary incomes varies considerably from one sector to another as certain types of primary incomes are receivable by only certain sectors or by non-residents. In particular, taxes are received only by the general government sector and non-residents while compensation of employees is received only by the household sector and non-residents.

(1) The balance of primary incomes of the non-financial and financial corporate sectors consists only of operating surplus plus property income receivable less property income payable.

(2) The balance of primary incomes of the general government sector consists of taxes, less subsidies, receivable or payable on production and on imports, plus property income receivable less property income payable. It may also include a small amount of operating surplus from government-owned unincorporated enterprises and from building services produced on own-account by government units.

(3) The balance of primary incomes of the household sector consists of compensation of employees and mixed incomes accruing to households, plus property income receivable less property income payable. It also includes the operating surplus from housing services produced for own consumption by owner-occupiers.

(4) The balance of primary incomes of the NPIs serving household sector consists almost entirely of property income receivable less property income payable.

Primary incomes in the form of compensation of employees, taxes or subsidies on production or imports, and property incomes (except rents on land) may all be receivable by residents from non-residents and payable to non-residents. The difference between the total values of the primary incomes receivable from, and payable to, non-residents is usually described as net income from abroad.

a. GNI and NNI

15. The aggregate value of the net balances of primary incomes across all sectors is described as net national income, or NNI. Similarly, the aggregate value of the gross balances of primary incomes for all sectors is now defined as gross national income, or GNI. The latter is identical with gross national product, or GNP, as hitherto understood in national accounts generally. However, both NNI and GNI are measures of income and not product.

16. As already explained, GDP at market prices is essentially a production measure obtained by summing the gross values added of all resident institutional units, in their capacities as producers, and adding the values of any taxes, less subsidies, on production or imports not already included in the values of the outputs, and values added, of resident producers. Gross value added is strictly a production measure defined only in terms of output and intermediate consumption. GNI is obtained by summing the balance of primary incomes for the same set of resident institutional units. It follows that the difference between the numerical values of GNI and GDP is equal to the difference between the total primary incomes receivable by residents from non-residents and the total primary incomes payable by residents to non-residents (i.e., net income from abroad). However, as both GDP and GNI are obtained by aggregating values added or balances of primary incomes over the same set of resident institutional units, there is no particular justification for describing one as "domestic" and the other as "national". Both aggregates refer to the total economy defined as the complete set of resident institutional units or sectors. The difference between them is not one of coverage but the fact that one measures output while the other measures income. Both have an equal claim to be described as domestic or as national. However, as the terms "domestic" and "national" are deeply embedded in economic usage, it is not proposed to change them but to underline the fact that GNP is actually an income concept by renaming it GNI.

3. The Entrepreneurial Income Account

17. The Allocation of Primary Income Account may be partitioned into two sub-accounts: the Entrepreneurial Income Account and the Allocation of Other Primary Income Account. The purpose is to identify an additional balancing item, entrepreneurial income, that may be useful for market producers. Like the operating surplus and mixed income, it is a balancing item that is only relevant to producers, but one which can only be calculated for institutional units and sectors and not for establishments and industries. The entrepreneurial income for a corporation, quasi-corporation, or institutional unit owning an unincorporated enterprise engaged in market production is defined as its

operating surplus or mixed income,

plus

property income receivable on the financial or other assets owned by the enterprise,

minus

interest payable on the liabilities of the enterprise and rents payable on land or other tangible non-produced assets rented by the enterprise.

It should be noted that, in the case of the non-financial and financial corporate sectors, the only difference between entrepreneurial income and the balance of primary incomes is that entrepreneurial income is measured before the payment of dividends and withdrawals of income from quasi-corporations. It is an income concept that is close to the concept of profit and loss as understood in business accounting (at least when there is no inflation) because it is calculated after deducting from the operating surplus any interest and rents payable and adding property incomes receivable. On the other hand, it should be remembered that when profits are calculated at historic costs in business accounts, they also include nominal holding gains on the inventories and other assets owned by the enterprise that may be quite substantial during inflationary conditions.

18. The entrepreneurial income of a corporation can be readily identified in its accounts. However, in the case of an institutional unit that owns an unincorporated enterprise, it is necessary to distinguish the assets and liabilities of the enterprise from those of its owner, typically a household or a government unit. In practice, it may be difficult to make this distinction, bearing in mind that the owner of an unincorporated enterprise is, by definition, legally indistinguishable from the enterprise itself and therefore responsible for all liabilities incurred by the enterprise. When an unincorporated enterprise can be treated as a quasi-corporation, it must be possible to identify the entrepreneurial income out of which income may be withdrawn by the owner(s), as the availability of the necessary accounting information is a prerequisite for being able to treat the enterprise as a quasi-corporation. For a household that owns an ordinary unincorporated enterprise, however, it may not always be feasible to divide the property incomes payable and receivable into those attributable to the enterprise and those attributable to the owner(s) in a personal capacity. In such cases it is not possible to estimate entrepreneurial income.

19. When the Entrepreneurial Income Account is compiled for an institutional unit or sector, it is followed by the Allocation of Other Primary Income Account in order to arrive at the balance of primary incomes. In the Allocation of Other Primary Income Account the first item listed under resources is entrepreneurial income, the balancing item carried forward from the Entrepreneurial Income Account instead of operating surplus or mixed income carried forward from the Generation of Income Account. The remaining primary incomes listed under resources in the Allocation of Other Primary Income Account therefore consist of the following items:

(1) compensation of employees receivable by households;

(2) taxes, less subsidies, receivable or payable by government units;

(3) property incomes receivable on assets owned except those receivable by enterprises and included in entrepreneurial income.

Under uses, the only items recorded are property incomes payable, except the interest or rents payable by enterprises. The balancing item of the

Allocation of Other Primary Income Account is identical with the balancing item of the Allocation of Primary Income Account.

B. Compensation of Employees

1. Introduction

20. Compensation of employees is recorded under uses in the Generation of Income Account and under resources in the Allocation of Primary Income Account. Compensation of employees is defined as:

> the total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the latter during the accounting period.

Compensation of employees is recorded on an accrual basis; that is, it is measured by the value of the remuneration in cash or in kind which an employee becomes entitled to receive from an employer in respect of work done during the relevant period, whether paid in advance, simultaneously or in arrears of the work itself. No compensation of employees is payable in respect of unpaid work undertaken voluntarily, including the work done by members of a household within an unincorporated enterprise owned by the same household. Compensation of employees does not include any taxes payable by the employer on the wage and salary bill - for example, a payroll tax. Such taxes are treated as taxes on production in the same way as taxes on buildings, land or other assets used in production.

21. It is not always self evident whether a worker is an employee or self-employed: for example, some workers paid by results may be employees while others may be self-employed. It is necessary therefore to clarify the nature of the employment relationship in order to fix the boundary between compensation of employees and other kinds of receipts. The boundary also affects the sub-sectoring of the household sector.

a. The employment relationship

22. In order to be classified as occupied - i.e., employed or self-employed - the person must be engaged in an activity that falls within the production boundary of the System. Unoccupied persons consist of the unemployed and persons not in the labour force. The relationship of employer to employee exists when there is an agreement, which may be formal or informal, between an enterprise and a person, normally entered into voluntarily by both parties, whereby the person works for the enterprise in return for remuneration in cash or in kind. The remuneration is normally based on either the time spent at work or some other objective indicator of the amount of work done.

23. Self-employed workers, on the other hand, are persons who are the sole owners, or joint owners, of the unincorporated enterprises in which they work, excluding those unincorporated enterprises that are classified as quasi-corporations. The self-employed are persons who work for themselves, when the enterprises they own are neither distinguished as separate legal entities nor separate institutional units in the System. Self-employed persons receive mixed incomes and not compensation of employees. It is useful to clarify the status of certain categories for whom it may not always be obvious as to whether they are employees, self-employed or unoccupied.

(1) Workers engaged in production undertaken entirely for their own final consumption or own capital formation, either individually or collectively, are self-employed. Although a value may be imputed for the output of own-account production based on costs, including estimated labour costs, no imputation is made for the wages of workers engaged in such production, even in the case of collective, or communal, projects undertaken by groups of persons working together. The surplus of the imputed value of the output over any monetary costs or taxes on production explicitly incurred is treated as gross mixed income.

(2) Unpaid family workers, including those working in unincorporated enterprises engaged wholly or partly on market production, are also treated as self-employed.

(3) The whole of the equity of a corporation may be owned by a single shareholder or small group of shareholders. When those shareholders also work for the corporation and receive paid remuneration other than dividends, they are treated as employees of the corporation. The owners of quasi-corporations are also treated as employees when they work in those quasi-corporations.

(4) Outworkers may be either employees or self-employed depending on their exact status and circumstances. The treatment of outworkers is specified in more detail below.

(5) Students in their capacity as consumers of educational or training services are not employees. However, if students also have a formal commitment whereby they contribute some of their own labour as an input into the enterprise's process of production - for example, as apprentices or similar kinds of worker trainees, articled clerks, student nurses, research or teaching assistants, hospital interns, etc. - they are treated as employees, whether or not they receive any remuneration in cash for the work which they do.

(i) Employers and own-account workers

24. Self-employed persons may be divided into two groups: namely, those with and without paid employees of their own. Those with paid employees are described as employers and those without paid employees are described as own-account workers. The distinction is used for purposes of sub-sectoring the household sector. Own-account workers may be further sub-divided into outworkers who are under some kind of formal or informal contract to supply goods or services to a particular enterprise, and ordinary own-account workers who may be engaged in either market production or non-market production for own final consumption or own capital formation.

(ii) Outworkers

25. An outworker is a person who agrees to work for a particular enterprise or to supply a certain quantity of goods or services to a particular enterprise, by prior arrangement or contract with that enterprise, but whose place of work is not within any of the establishments which make up that enterprise. The enterprise does not control the time spent at work by an outworker and does not assume responsibility for the conditions in which that work is carried out, although it may carry out checks on the quality of work. Most outworkers work at home but may use other premises of their own choice. Some outworkers are provided by an enterprise with the equipment or materials, or both, on which they work, but other outworkers may purchase their own equipment or materials, or both. In any case, outworkers have to meet some production costs themselves: for example, the actual or imputed rent on the buildings in which they work; heating, lighting and power; storage or transportation; etc.

26. Outworkers have some of the characteristics of employees and some of the characteristics of self-employed workers. The way in which they are to be classified is determined primarily by the basis on which they are remunerated. A distinction can be drawn between two cases which, in principle, are quite different from each other:

(a) The person is remunerated directly, or indirectly, on the basis of the amount of work done - that is, by the amount of labour which is contributed as an input into some process of production, irrespective of the value of the output produced or the profitability of the production process. This kind of remuneration implies that the worker is an employee.

or

(b) The income received by the person is a function of the value of the outputs from some process of production for which that person is responsible, however much or little work was put in. This kind of remuneration implies that the worker is self-employed.

27. In practice, it may not always be so easy to distinguish between employees and self-employed on the basis of these criteria. Outworkers who employ and pay others to do the same kind of work must be treated as the self-employed owners of unincorporated enterprises: i.e., as employers. The issue, therefore, is to distinguish own-account workers from employees.

28. An outworker is considered an employee when there exists an employment relationship between the enterprise and the outworker of the kind described in <paragraph 22 above.> This implies the existence of an implicit or explicit contract or agreement whereby it is agreed that the outworker is remunerated on the basis of the work done. Conversely, an outworker is considered to be an own-account worker when there is no such implicit or explicit contract or agreement and the income earned by the outworker depends on the value of the goods or services supplied to the enterprise. This suggests that decisions on markets, scale of operations and finance are likely to be in the hands of the outworker who is also likely to own, or rent, the machinery or equipment on which he or she works.

29. The status of an outworker has important implications for the accounts. When the outworker is an own-account worker, the payment from the enterprise to the outworker constitutes a purchase of intermediate goods or services. When the outworker is an employee, the payment constitutes compensation of employees and is therefore paid out of the value added of the enterprise. Thus, the outworker's status affects the distribution of value added between enterprises as well as the distribution of incomes between compensation of employees and net mixed income.

b. The components of compensation of employees

30. Compensation of employees has two main components, namely:

(1) wages and salaries payable in cash or in kind;

(2) the value of the social contributions payable by employers: these may be:

actual social contributions payable by employers to social security schemes or to private funded social insurance schemes to secure social benefits for their employees,

or

imputed social contributions by employers providing unfunded social benefits.

c. Wages and salaries

31. Wages and salaries include the values of any social contributions, income taxes, etc. payable by the employee even if they are actually withheld by the employer for administrative convenience or other reasons and paid directly to social insurance schemes, tax authorities, etc. on behalf of the employee. Wages and salaries may be paid in various ways, including goods or services provided to employees as remuneration in kind instead of, or in addition to, remuneration in cash.

(i) Wages and salaries in cash

32. Wages and salaries in cash include the following kinds of remuneration:

(1) wages or salaries payable at regular weekly, monthly or other intervals, including payments by results and piecework payments; enhanced payments or special allowances for working overtime, at nights, at weekends or other unsocial hours; allowances for working away from home or in disagreeable or hazardous circumstances; ex-patriation allowances for working abroad; and so on;

(2) supplementary allowances payable regularly, such as housing allowances or allowances to cover the costs of travel to and from work, but excluding social benefits (see below);

(3) wages or salaries payable to employees away from work for short periods, e.g., on holiday or as a result of a temporary halt to production, except during absences due to sickness, injury, etc. (see below);

(4) ad hoc bonuses or other exceptional payments linked to the overall performance of the enterprise made under incentive schemes;

(5) commissions, gratuities and tips received by employees: these should be treated as payments for services rendered by the enterprise employing the worker, and should therefore also be included in the output and gross value added of the employing enterprise when they are paid directly to the employee by a third party.

33. Wages and salaries in cash do not include the reimbursement by employers of expenditures made by employees in order to enable them to take up their jobs or to carry out their work. For example:

(1) the reimbursement of travel, removal or related expenses made by employees when they take up new jobs or are required by their employers to move their homes to different parts of the country or to another country;

(2) the reimbursement of expenditures by employees on tools, equipment, special clothing or other items that are needed exclusively, or primarily, to enable them to carry out their work.

The amounts reimbursed are treated as intermediate consumption by employers. To the extent that employees who are required by their contract of employment to purchase tools, equipment, special clothing, etc. are not fully reimbursed, the remaining expenses they incur should be deducted from the amounts they receive in wages and salaries and the employers' intermediate consumption increased accordingly. Expenditures on items needed exclusively, or primarily, for work do not form part of household final consumption expenditures, whether reimbursed or not.

34. Wages and salaries in cash also do not include unfunded employee social benefits <<see chapter VIII, Secondary Distribution of Income Accounts, paragraphs 80>> paid by employers in the form of:

(1) children's, spouses', family, education or other allowances in respect of dependents;

(2) payments made at full, or reduced, wage or salary rates to workers absent from work because of illness, accidental injury, maternity, etc.;

(3) severance payments to workers or their survivors who lose their jobs because of redundancy, incapacity, accidental death, etc.

In practice, it may be difficult to separate payments of wages or salaries during short periods of absence due to sickness, accidents, etc. from other payments of wages and salaries, in which case they have to be grouped with the latter.

35. Unfunded employee social benefits are not a form of remuneration because they are paid selectively to individual employees when certain events occur, or certain conditions exist, that are unrelated to the amount of work done by the employee. However, as explained below, an amount equal to the value of the additional contingent liabilities that employers incur by undertaking to provide such benefits to their employees out of their own resources, should the needs arise, must be treated as a form of compensation made collectively to their employees.

(ii) Wages and salaries in kind

36. Employers may remunerate their employees in kind for various reasons. For example:

- There may be tax advantages for the employer, the employee, or both by avoiding payments in cash;

- The employer may wish to dispose of outputs which are periodically in excess supply;

- The nature of the work may require frequent, or prolonged, absence from home so that the employee has to be provided with accommodation, travel, etc.;

37. Income in kind may bring less satisfaction than income in cash because employees are not free to choose how to spend it. Some of the goods or services provided to employees may be of a type or quality which the employee would not normally buy. Nevertheless, they must be valued consistently with other goods and services. When the goods or services have been purchased by the employer, they should be valued at purchasers' prices. When produced by the employer, they should be valued at producers' prices. When provided free, the value of the wages and salaries in kind is given by the full value of the goods and services in question. When provided at reduced prices, the value of the wages and salaries in kind is given by the difference between the full value of the goods and services and the amount paid by the employers.

38. Goods or services that employers are obliged to provide to their employees in order for them to be able to carry out their work are treated as intermediate consumption by the employer: for example, special protective clothing. A list of such items is given in <<paragraph 162 of chapter VI, Production Account.>> Remuneration in kind, on the other hand, consists of goods and services that are not necessary for work and can be used by employees in their own time, and at their own discretion, for the satisfaction of their own needs or wants or those of other members of their households.

39. Almost any kind of consumption good or service may be provided as remuneration in kind. The following list includes some of the most common types of goods and services provided without charge, or at reduced prices, by employers to their employees:

(1) meals and drinks, including those consumed when travelling on business;

(2) housing services or accommodation of a type that can be used by all members of the household to which the employee belongs;

(3) uniforms or other forms of special clothing which employees choose to wear frequently outside of the work place as well as at work;

(4) the services of vehicles or other durables provided for the personal use of employees;

(5) health or other insurance provided to individual employees under individual insurance policies (but not under social insurance schemes);

(6) goods and services produced as outputs from the employer's own processes of production, such as free travel for the employees of railways or airlines, or free coal for miners;

(7) the provision of sports or recreation facilities for employees and their families;

(8) transportation to and from work, car parking;

(9) creches for the children of employees.

40. Some of the services provided by employers, such as transportation to and from work, car parking and creches have some of the characteristics of intermediate consumption. However, employers are obliged to provide these facilities to attract and retain labour, and not because of the nature of the production process or the physical conditions under which employees have to work. On balance, they are more like other forms of compensation of employees than intermediate consumption. Many workers have to pay for transportation to and from work, car parking and creches out of their own incomes, the relevant expenditures being recorded as final consumption expenditures.

41. Remuneration in kind may also include the value of the interest foregone by employers when they provide loans to employees at reduced, or even zero, rates of interest for purposes of buying houses, furniture or other goods or services. Its value may be estimated as the amount the employee would have to pay if average mortgage, or consumer loan, interest rates were charged less the amount of interest actually paid. The sums involved could be large when nominal interest rates are very high because of inflation but otherwise they may be too small and too uncertain to be worth estimating.

42. Wages and salaries in kind do not include unfunded employee social benefits <<see chapter VIII, Secondary Distribution of Income Accounts, paragraph 80>> in the form of the provision of free medical services (other than those necessitated by the nature of the work) to employees or their families is treated as an unfunded employee social benefit. The value of the goods or services provided at reduced prices is measured by the difference between their costs to the employers and the amounts paid by the employees. As explained above in paragraph 35, these benefits are not a form of remuneration because they are paid selectively to individual employees when certain events occur that are unrelated to the amount of work done.

d. Employers' social contributions

43. An amount equal to the value of the social contributions incurred by employers in order to obtain social benefits for their employees needs to be recorded under compensation of employees. Employers' social contributions may be either actual or imputed. They are intended to secure for their employees the entitlement to social benefits should certain events occur, or certain circumstances exist, that may adversely affect their employees' income or

welfare - sickness, accidents, redundancy, retirement, etc. Social benefits are described in <chapter VIII, Secondary Distribution of Income>.

(i) Employers' actual social contributions

44. These consist of social contributions payable by employers for the benefit of their employees to third parties such as social security funds, insurance enterprises or other institutional units responsible for the administration and management of social insurance schemes. Although they are paid by the employer directly to the social security fund or other scheme, the payments are made for the benefit of the employees. Accordingly, employees should be treated as being remunerated by an amount equal to the value of the social contributions payable. This imputed remuneration is recorded in the Generation of Income Account as a component of compensation of employees. Employees are then recorded as paying social contributions of equal value as current transfers to social security funds, other schemes, etc. in the Secondary Distribution of Income Account except that contributions to private funded schemes are recorded less the value of service charges.

(ii) Employers' imputed social contributions

45. Some employers provide social benefits themselves directly to their employees, ex-employees or dependents out of their own resources without involving any third party, such as an insurance enterprise, and without establishing a separate institutional unit in the form of a special fund or reserve for the purpose. In this situation, existing employees may be considered as being protected against various specified needs or circumstances, even though no payments are being made to third parties to cover them. Remuneration should therefore be imputed for such employees equal in value to the amount of social contributions that would be needed to secure the de facto entitlements to the social benefits they accumulate.

46. It may be difficult to decide how large such imputed remuneration and imputed contributions should be in practice. The enterprise may make estimates itself, perhaps on the basis of the contributions paid into similar funded schemes, in order to calculate its likely liabilities in the future, and such estimates may be used when available. Otherwise, the only practical alternative may be to use the unfunded social benefits payable by the enterprise during the same accounting period as an estimate of the imputed remuneration that would be needed to cover the imputed contributions. While there are obviously many reasons why the value of the imputed contributions that would be needed may diverge from the unfunded social benefits actually paid in the same period, such as the changing composition and age structure of the enterprise's labour force, the benefits actually paid in the current period may nevertheless be the best available estimate of the appropriate imputed remuneration and contributions.

47. The two steps involved may be summarised as follows:

(1) Employers are recorded, in the Generation of Income Account, as paying to their existing employees as a component of compensation an amount equal in value to the estimated social contributions that would be needed to provide for the unfunded social benefits to which they become entitled.

(2) Employees are recorded, in the Secondary Distribution of Income Account, as paying back to their employers the same amount in the form of imputed social contributions (i.e., current transfers) as if they were paying them to a social insurance scheme.

C. Taxes on Production and on Imports

1. Introduction

48. Taxes are compulsory, unrequited payments, in cash or in kind, made by institutional units to government units. They are described as unrequited because the government provides nothing in return to the individual unit making the payment, although governments may use the funds raised in taxes to provide goods or services to other units, either individually or collectively, or to the community as a whole.

49. Taxes on production consist of:

taxes on products payable on outputs of goods and services when they are produced, sold, transferred or otherwise disposed of by their producers;

plus

other taxes on production, consisting mainly of taxes on the ownership or use of land, buildings or other assets used in production or on the labour employed, or compensation of employees paid.

It should be noted, however, that not all taxes on domestically produced products are recorded in the System as being payable by their producers.

50. Taxes on imports consist of:

taxes on products (other than VAT) which become payable when goods enter the economic territory by crossing the actual frontier, or the customs frontier, or when services are delivered to resident units by non-resident units.

They are taxes on products, many of which are the same as taxes payable on the outputs of resident producers.

51. At the level of an individual enterprise, taxes on production are recorded as being payable out of its value added. Similarly, in business accounting they are regarded as costs of production that may be charged against sales or other receipts when calculating profits for tax or other purposes. They correspond grosso modo to "indirect taxes" as traditionally understood, indirect taxes being taxes that supposedly can be passed on, in whole or in part, to other institutional units by including them in the prices of the goods or services sold. However, it is extremely difficult, if not impossible, to determine the real incidence of different kinds of taxes, and the use of the terms "direct" and "indirect" taxes has fallen out of favour in economics and is no longer used in the System.

a. The recording of taxes on production and imports in the accounts

52. Taxes on production and imports are recorded under uses in the Generation of Income Account and under resources in the Allocation of Primary Income Account.

53. In the Generation of Income Account, taxes on imports are recorded only at the level of the total economy as they are not payable out of the values added of domestic producers. Moreover, at the level of an individual institutional unit or sector, only those taxes on products that have not already been deducted from the value of the output of that unit or sector need to be recorded under uses in its Generation of Income Account. These vary depending upon the way in which output is valued. When output is valued at basic prices, all taxes and subsidies on products payable or receivable on the goods or services produced as outputs are excluded from the value of that output and hence from the value added derived from it. They do not therefore appear under uses in the Generation of Income Accounts of the units or sectors concerned, being recorded only at the level of the total economy, in the same way as taxes on imports. When output is valued at producers' prices, all taxes or subsidies on products payable or receivable on outputs have to be recorded under uses in the Generation of Income Accounts of the units or sectors concerned, except invoiced VAT or similar deductible taxes that are always excluded from the value of output. Non-deductible VAT and similar taxes are recorded under uses only at the level of the total economy, like taxes on imports.

54. Other taxes or subsidies on production - that is, taxes payable on the land, assets, labour, etc. employed in production - are never deducted from the value of output and hence are always recorded as being payable out of the values added of the individual producers or sectors concerned.

55. In the Allocation of Primary Income Account, taxes on production and imports appear under resources only for the general government sector and the total economy, apart from any such taxes payable to non-residents.

b. Taxes versus fees

56. One of the regulatory functions of governments is to forbid the ownership or use of certain goods or the pursuit of certain activities, unless specific permission is granted by issuing a license or other certificate for which a fee is demanded. If the issue of such licenses involves little or no work on the part of government, the licenses being granted automatically on payment of the amounts due, it is likely that they are simply a device to raise taxes, even though the government may provide some kind of certificate, or authorisation, in return. However, if the government uses the issue of licenses to exercise some proper regulatory function - for example, checking the competence, or qualifications, of the person concerned, checking the efficient and safe functioning of the equipment in question, or carrying out some other form of control which it would otherwise not be obliged to do - the payments made should be treated as purchases of services from government rather than payments of taxes, unless the payments are clearly out of all proportion to the costs of providing the services. The borderline between taxes and payments of fees for services rendered is not always clear cut in practice, however.

c. Links with the IMF and OECD tax classifications

57. The coverage of taxes in the SNA coincides with that of "tax revenue" as defined in the Manual on Government Finance Statistics, 1986, or GFS, of the International Monetary Fund (IMF), and also with "taxes" as defined in the Organisation for Economic Co-operation and Development's (OECD) annual publication Revenue Statistics of OECD Member Countries, except that the SNA includes imputed taxes or subsidies resulting from the operation of official multiple exchange rates and does not classify Social Security Contributions under the heading of taxes. Chapter IV of the GFS contains a detailed listing and classification of taxes according to the nature of the tax. This classification is also reprinted as Annex IV in the Handbook of National Accounting: Public Sector Accounts (United Nations, 1988). Part II of Revenue Statistics contains an almost identical classification.

58. The categories of tax distinguished in the System depend on the interaction of three factors, of which the nature of tax is only one, namely:

(1) the nature of the tax, as specified in the GFS/OECD classification;

(2) the type of institutional unit paying the tax;

(3) the circumstances in which the tax is payable.

59. Thus, payments of exactly the same tax may be recorded under two different headings in the SNA. For example, payment of an excise duty may appear under "taxes on imports, except VAT and duties" or under "taxes on products, except VAT, import and export taxes" depending upon whether the

excise duty is paid on an imported or domestically produced good. Similarly, payments of the same tax, for example an annual tax on automobiles, may be recorded under "taxes on production" or under "current taxes on income, wealth, etc." depending upon whether the tax is paid by an enterprise or by a household. For this reason, it is not possible to arrive at the SNA categories simply by regrouping the IMF/OECD classifications. However, in order to benefit from the existence of these detailed classifications, each category of tax listed below contains a cross-reference to the corresponding IMF and OECD classifications.

d. The full accrual basis of recording

60. In contrast to the GFS and similar publications that require taxes to be recorded when they are actually paid, all taxes should be recorded on a full accrual basis in the SNA: that is, when the activities, transactions or other events occur which create the liabilities to pay taxes. However, some economic activities, transactions or events, which under tax legislation ought to impose on the units concerned the obligation to pay taxes, permanently escape the attention of the tax authorities. It would be unrealistic to assume that such activities, transactions or events give rise to financial assets or liabilities in the form of payables and receivables. For this reason, the amounts of taxes to be recorded in the System are determined by the amounts due for payment only when evidenced by tax assessments, declarations or other instruments, such as sales invoices or Customs declarations, which create liabilities in the form of clear obligations to pay on the part of taxpayers. Nevertheless, in accordance with the full accrual principle, the times at which the taxes should be recorded are the times at which the tax liabilities arise. For example, a tax on the sale, transfer or use of output should be recorded when that sale, transfer or use took place, which is not necessarily the same time as that at which the tax authorities were notified, at which a tax demand was issued, at which the tax was due to be paid or the payment was actually made.

61. In some countries, and for some taxes, the amounts of taxes eventually paid may diverge substantially and systematically from the amounts due to be paid to the extent that not all of the latter can be effectively construed as constituting financial liabilities as these are understood within the System. In such cases, it may be preferable for analytic and policy purposes to ignore unpaid tax liabilities and confine the measurement of taxes within the System to those actually paid. Nevertheless, the taxes actually paid should still be recorded on a full accrual basis at the times at which the events took place which gave rise to the liabilities.

e. Interest, fines or other penalties

62. In principle, interest charged on overdue taxes or fines, or penalties imposed for the attempted evasion of taxes, should not be recorded as taxes but should be recorded separately. However, it may not be possible to separate payments of interest, fines or other penalties from the taxes to which they relate, so that they are usually grouped with taxes in practice.

2. Taxes on products

63. A tax on a product is a tax that is payable per unit of some good or service. The tax may be a specific amount of money per unit of quantity of a good or service (the quantity units being measured either in terms of discrete units or continuous physical variables such as volume, weight, strength, distance, time, etc.) or it may be calculated ad valorem as a specified percentage of the price per unit or value of the goods or services transacted. A tax on a product usually becomes payable when it is produced, sold or imported, but it may also become payable in other circumstances, such as when a good is exported, leased, transferred, delivered, or used for own consumption or own capital formation. An enterprise may or may not itemise the amount of a tax on a product separately on the invoice or bill which they charge their customers.

a. Value added type taxes

64. A value added type tax (VAT) is a tax on goods or services collected in stages by enterprises but which is ultimately borne by the final purchasers. It has already been described in <<chapter VI, Production Account, paragraphs 213 to 220>>. It is described as a "deductible" tax because producers are not usually required to pay to the government the full amount of the tax they invoice to their customers, being permitted to deduct the amount of tax they have been invoiced on their own purchases of goods or services intended for intermediate consumption or fixed capital formation. VAT is usually calculated on the price of the good or service including any other tax on the product. VAT is also payable on imports of goods or services in addition to any import duties or other taxes on the imports.

b. Taxes and duties on imports, excluding VAT

65. Taxes on imports consist of taxes on goods and services that become payable at the moment when those goods cross the national or customs frontiers of the economic territory or when those services are delivered by non-resident producers to resident institutional units.

66. Imported goods on which all the required taxes on imports have been paid when they enter the economic territory may become subject to a further tax, or taxes, as they circulate within the economy. For example, excise duties or

sales taxes may become due on goods as they pass through the chain of wholesale or retail distribution, such taxes being levied on all goods at the same point, whether those goods have been produced by resident enterprises or imported. Taxes payable in this way on goods which have been already imported are not taxes on imports, being recorded under taxes on products, excluding VAT, import and export taxes.

(i) Import duties

67. These consist of customs duties, or other import charges, which are payable on goods of a particular type when they enter the economic territory. The duties are specified under customs tariff schedules. They may be intended as a means of raising revenue or discouraging imports in order to protect resident goods producers (GFS, 6.1; OECD, 5123).

(ii) Taxes on imports, excluding VAT and duties

68. These consist of all taxes except VAT and import duties as defined in the GFS/OECD classifications that become payable when goods enter the economic territory or services are delivered by non-residents to residents.

(1) General sales taxes: these consist of general sales taxes (excluding VAT) that are payable on imports of goods and services when the goods enter the economic territory or the services are delivered to residents. (GFS, 5.1; OECD, 5110-5113)

(2) Excise duties: excise duties are taxes levied on specific kinds of goods, typically alcoholic beverages, tobacco and fuels; they may be payable in addition to import duties when the goods enter the economic territory. (GFS, 5.2; OECD, 5121)

(3) Taxes on specific services: these may be payable when non-resident enterprises provide services to resident units within the economic territory. (GFS, 5.4; OECD, 5126)

(4) Profits of import monopolies: these consist of the profits transferred to governments of import marketing boards, or other public enterprises exercising a monopoly over the imports of some good or service. The justification for treating these profits as implicit taxes on products is the same as that given below <<paragraph 68>> for fiscal monopolies. (GFS, 6.3; OECD, 5127)

(5) Taxes resulting from multiple exchange rates: these consist of implicit taxes resulting from the operation of multiple exchange rates by the central bank or other official agency. Central banks or other official agencies may sell foreign currency to importers at different rates of exchange from those at which they buy foreign currency from exporters, and also apply different rates of

exchange to different categories of imports or exports. This practice is an alternative to utilising a single exchange rate and imposing taxes, or granting subsidies, on various categories of imports or exports. The implicit taxes or subsidies on imports or exports can be estimated from the differences between the rates at which the central bank actually sells or buys foreign currency and an average rate covering all the foreign exchange transactions of the central bank, less any estimated bank service charges on foreign exchange transactions. These implicit taxes are not recorded in the same way as other taxes: <see chapter XIV, External Account, and chapter XIX, Application of the Integrated Framework to Various Circumstances and Needs> for an explanation of the treatment of multiple exchange rates in the System as a whole.

c. Export taxes

69. Export taxes consist of taxes on goods or services that become payable when the goods leave the economic territory or when the services are delivered to non-residents. They include the following taxes:

(1) Export duties: general or specific taxes or duties on exports. (GFS, 6.2; OECD, 5124)

(2) Profits of export monopolies: these consist of the profits transferred to governments of export marketing boards, or other public enterprises exercising a monopoly over the exports of some good or service. The justification for treating these profits as implicit taxes on products is the same as that given below <<paragraph 68>> for fiscal monopolies. (GFS, 6.3: OECD, 5124)

(3) Taxes resulting from multiple exchange rates: these consist of implicit taxes on exports resulting from the operation of an official system of multiple exchange rates <<see paragraph 66 (5) above, chapter XIV, External Account, and chapter XIX, Application of the Integrated Framework to Various Circumstances and Needs>>.

d. Taxes on products, excluding VAT, import and export taxes

70. Taxes on products, excluding VAT, import and export taxes, consist of taxes on goods and services produced as outputs of resident enterprises that become payable as a result of the production, sale, transfer, leasing or delivery of those goods or services, or as a result of their use for own consumption or own capital formation. They include the following commonly occurring taxes.

(1) General sales or turnover taxes: these include manufacturers', wholesale and retail sales taxes, purchase taxes, turnover taxes, and so on, but excluding VAT. (GFS, 5.1; OECD, 5110-5113)

(2) Excise duties: these consist of taxes levied on specific kinds of goods, typically alcoholic beverages, tobacco and fuels. (GFS, 5.2; OECD, 5121)

(3) Taxes on specific services: these include taxes on transportation, communications, insurance, advertising, hotels or lodging, restaurants, entertainments, gambling and lotteries, sporting events, and so on. (GFS, 5.4; OECD, 5126)

(4) Profits of fiscal monopolies: these consist of the profits of fiscal monopolies that are transferred to government. Fiscal monopolies are public corporations, public quasi-corporations, or government-owned unincorporated enterprises which have been granted a legal monopoly over the production or distribution of a particular kind of good or service in order to raise revenue and not in order to further the interests of public economic or social policy. Such monopolies are typically engaged in the production of goods or services which may be heavily taxed in other countries: for example, alcoholic beverages, tobacco, matches, petroleum products, salt, playing cards and so on. The exercise of monopoly powers is simply an alternative way for the government to raise revenue instead of the more overt procedure of taxing the private production of such products. In such cases, the sales prices of the monopolies are deemed to include implicit taxes on the products sold. While in principle only the excess of the monopoly profits over some notional "normal" profits should be treated as taxes, it is difficult to estimate this amount, and, in practice, the value of the taxes should be taken as equal to the amount of the profits actually transferred from fiscal monopolies to government. (GFS, 5.3; OECD, 5122)

When a public enterprise is granted monopoly powers as a matter of deliberate economic or social policy because of the special nature of the good or service or the technology of production - for example, public utilities, post offices and telecommunications, railways, and so on - it should not be treated as a fiscal monopoly. As a general rule, fiscal monopolies tend to be confined to the production of consumer goods or fuels.

As the profits of a fiscal monopoly are calculated for the enterprise as a whole, it is not possible to estimate the average amount of the tax per unit of good or service sold when the enterprise has more than one good or service as output without introducing an assumption about the rates of tax on the different products. Unless there is good reason otherwise, it should be assumed that the same ad valorem rate of tax is applied to all products, this rate being given by the ratio of the total value of the implicit taxes to the value of total sales less the total value of the implicit taxes. It is

necessary to establish this rate in order to be able to calculate the basic prices of the products concerned.

3. Other taxes on production

71. These consist of all taxes except taxes on products that enterprises incur as a result of engaging in production. Such taxes do not include any taxes on the profits or other income received by the enterprise and are payable irrespective of the profitability of the production. They may be payable on the land, fixed assets or labour employed in the production process or on certain activities or transactions. Other taxes on production include the following:

(1) Taxes on payroll or work force: these consist of taxes payable by enterprises assessed either as a proportion of the wages and salaries paid or as a fixed amount per person employed. They do not include compulsory social security contributions paid by employers or any taxes paid by the employees themselves out of their wages or salaries. (GFS, 3; OECD, 3000)

(2) Recurrent taxes on land, buildings or other structures: these consist of taxes payable regularly, usually each year, in respect of the use or ownership of land, buildings or other structures utilised by enterprises in production, whether the enterprises own or rent such assets. (GFS, 4.1; OECD, 4100)

(3) Business and professional licences: these consist of taxes paid by enterprises in order to obtain a license to carry on a particular kind of business or profession. However, if the government carries out checks on the suitability, or safety of the business premises, on the reliability, or safety, of the equipment employed, on the professional competence of the staff employed, or on the quality or standard of goods or services produced, as a condition for granting such a license, the payments are not unrequited and should be treated as payments for services rendered, unless the amounts charged for the licenses are out of all proportion to the costs of the checks carried out by governments. (GFS, 5.5.1; OECD, 5210)

(4) Taxes on the use of fixed assets or other activities: these include taxes levied periodically on the use of vehicles, ships, aircraft or other machinery or equipment used by enterprises for purposes of production, whether such assets are owned or rented. These taxes are often described as licenses, and are usually fixed amounts which do not depend on the actual rate of usage. (GFS, 5.5.2 and 5.5.3; OECD, 5200)

(5) Taxes on financial and capital transactions: these consist of taxes payable on the purchase or sale by enterprises of financial

and non-financial assets. They become payable when the ownership of land or other assets changes, except as a result of capital transfers (mainly inheritances and gifts). (GFS, 4.4; OECD, 4400)

(6) Stamp taxes: these consist of stamp taxes which do not fall on particular classes of transactions already identified: for example, stamps on legal documents or cheques. However, stamp taxes on the sale of specific products, such as alcoholic beverages or tobacco, are treated as taxes on products. (GFS, 7.2; OECD, 6200)

(7) Taxes on pollution: these consist of taxes levied on the emission or discharge into the environment of noxious gases, liquids or other harmful substances. They do not include payments made for the collection and disposal of waste or noxious substances by public authorities, which constitute intermediate consumption of enterprises. (GFS, 7.3; OECD, 5200)

(8) Taxes on international transactions: these consist of taxes levied on the sale or purchase of foreign exchange, or both, and taxes on travel abroad, foreign remittances or similar transactions with non-residents. (GFS, 6.5 and 6.6; OECD, 5127)

D. Subsidies

72. Subsidies are current unrequited payments that government units, including non-resident government units, make to enterprises on the basis of the levels of their production activities or the quantities or values of the goods on services which they produce, sell or import. They are receivable by resident producers or importers. In the case of resident producers they may be designed to influence their levels of production, the prices at which their outputs are sold or the remuneration of the institutional units engaged in production. Subsidies are equivalent to negative taxes on production in so far as their impact on the operating surplus is in the opposite direction to that of taxes on production.

73. Subsidies are not payable to final consumers, and current transfers that governments make directly to households as consumers are treated as social benefits. Subsidies also do not include grants that governments may make to enterprises in order to finance their capital formation, or compensate them for damage to their capital assets, such grants being treated as capital transfers.

1. Subsidies on products

74. A subsidy on a product is a subsidy payable per unit of a good or service produced. The subsidy may be a specific amount of money per unit of quantity of a good or service, or it may be calculated ad valorem as a specified percentage of the price per unit. A subsidy may also be calculated as the difference between a specified target price and the market price actually paid by a buyer. A subsidy on a product usually becomes payable when the good or service is produced, sold or imported, but it may also be payable in other circumstances such as when a good is transferred, leased, delivered or used for own consumption or own capital formation.

a. Import subsidies

75. Import subsidies consist of subsidies on goods and services that become payable when the goods cross the frontier of the economic territory or when the services are delivered to resident institutional units. They include implicit subsidies resulting from the operation of a system of official multiple exchange rates <<see paragraph 66 (5) above, chapter XIV, External Account, and chapter XIX, Application of the Integrated Framework to Various Circumstances and Needs>>. They may also include losses incurred as a matter of deliberate government policy by government trading organisations whose function is to purchase products from non-residents and then sell them at lower prices to residents (see also export subsidies below.)

76. As in the case of taxes on products, subsidies on imported goods do not include any subsidies that may be payable on such goods after they have crossed the frontier and entered into free circulation within the economic territory of the country.

b. Export subsidies

77. Export subsidies consist of all subsidies on goods and services that become payable when the goods leave the economic territory or when the services are delivered to non-resident units. They include the following:

(1) Direct subsidies on exports payable directly to resident producers when the goods leave the economic territory or the services are delivered to non-residents.

(2) Losses of government trading organisations: these consist of losses incurred as a matter of deliberate government policy by government trading organisations whose function is to buy the products of resident enterprises and then sell them at lower prices to non-residents. The difference between the buying and selling prices is an export subsidy <<see also paragraph 77 (2) below>>.

(3) Subsidies resulting from multiple exchange rates: these consist of implicit subsidies resulting from the operation of an official system of multiple exchange rates <<see paragraph 66 (5) above, chapter XIV, External Account, and chapter XIX, Application of the Integrated Framework to Various Circumstances and Needs>>.

(i) Exclusions from export subsidies

78. Export subsidies do not include the repayment at the customs frontier of taxes on products previously paid on goods or services while they were inside the economic territory. They also exclude the waiving of the taxes that would be due if the goods were to be sold or used inside the economic territory instead of being exported. General taxes on products such as sales or purchase taxes, VAT, excise taxes or other taxes on products are usually not payable on exports.

c. Other subsidies on products

79. Other subsidies on products consist of subsidies on goods or services produced as the outputs of resident enterprises that become payable as a result of the production, sale, transfer, leasing or delivery of those goods or services, or as a result of their use for own consumption or own capital formation. The most common types are the following:

(1) Subsidies on products used domestically: these consist of subsidies payable to resident enterprises in respect of their outputs which are used or consumed within the economic territory.

(2) Losses of government trading organisations: these consist of the losses incurred by governmen trading organisations whose function is to buy and sell the produc s of resident enterprises. When such organisations incur losses as a matter of deliberate government economic or social policy by selling at lower prices than those at which they purchased the goods, the difference between the purchase and the selling prices should be treated as a subsidy. Entries to the inventories of goods held by such organisations are valued at the purchasers' prices paid by the trading organisations and the subsidies recorded at the time the goods are sold.

(3) Subsidies to public corporate and quasi-corporate enterprises: these consist of regular transfers paid to public corporate and quasi-corporate enterprises which are intended to compensate for persistent losses - i.e., negative operating surpluses - which they incur on their productive activities as a result of charging prices which are lower than their average costs of production as a matter of deliberate government economic and social policy. In order to calculate the basic prices of the outputs of such

enterprises, it will usually be necessary to assume a uniform ad valorem implicit rate of subsidy on those outputs determined by the size of the subsidy as a percentage of the value of sales plus subsidy.

2. Other subsidies on production

80. These consist of subsidies except subsidies on products which resident enterprises may receive as a consequence of engaging in production. Such subsidies may become payable in the following kinds of circumstances.

(1) Subsidies on payroll or work force: these consist of subsidies payable on the total wage or salary bill, or total work force, or on the employment of particular types of persons such as physically handicapped persons or persons who have been unemployed for long periods. The subsidies may also be intended to cover some or all of the costs of training schemes organised or financed by enterprises.

(2) Subsidies on the use of inputs: these consists of subsidies intended to encourage the use of particular kinds of inputs into the production process.

(3) Subsidies to reduce pollution: these consist of subsidies intended to cover some or all of the costs of additional processing undertaken to reduce or eliminate the discharge of pollutants into the environment.

E. Operating Surplus or Mixed Income

81. Operating surplus and mixed income are two alternative names for the same balancing item used for different types of enterprises. Operating surplus or mixed income is the balancing item in the Generation of Income Account: it is defined as:

value added

minus

compensation of employees payable

minus

taxes on production payable

plus

subsidies receivable.

As already noted, value added should be measured net - that is, after deducting consumption of fixed capital - but provision has to be made in the accounts of the system for value added, and hence all subsequent balancing items that depend on value added, to be measured gross or net of consumption of fixed capital because of the practical difficulty of measuring the latter. Value added may be assumed to be measured net, unless stated to the contrary.

82. Mixed income is the term reserved for the balancing item of the Generation of Income Account of unincorporated enterprises owned by members of households, either individually or in partnership with others, in which the owners, or other members of their households, may work without receiving any wage or salary. In practice, all unincorporated enterprises owned by households that are not quasi-corporations are deemed to fall in this category, except owner-occupiers in their capacity as producers of housing services for own final consumption and employers of paid domestic servants that generate no surplus.

83. Operating surplus/mixed income is a measure of the surplus accruing from processes of production before deducting any explicit or implicit interest charges, rents or other property incomes payable on the financial assets, land or other tangible non-produced assets required to carry on the production. It is therefore invariant to whether:

(1) the land or other tangible non-produced assets used in production are owned or rented by the enterprise;

and

(2) the inventories, fixed assets, land or other non-produced assets owned by the enterprise and used in production are financed out of own funds (or equity capital) or out of borrowed funds (or loan capital).

Although the operating surplus/mixed income is invariant to the extent to which land is owned or assets in general are financed, it needs to be sufficient to cover both any explicit, or implicit, rents on land and the explicit, or implicit interest charges on the value of all the assets owned by the enterprise in order to justify their continued use in production. The implicit interest costs of using the enterprise's own funds to purchase inventories, fixed assets or other assets are the opportunity costs of using the funds in this way rather than to acquire financial assets on which actual interest could be earned. The amounts of rents and interest actually payable on rented land and borrowed funds are recorded in the Allocation of Primary Income Account, and the Entrepreneurial Income Account, but the implicit rents on land owned by the enterprise and the implicit interest chargeable on the use of the enterprise's own funds are not recorded in the accounts of the System.

84. The operating surplus/mixed income is not invariant, however, to the extent to which the fixed assets used in production are owned or rented. When

buildings, other structures, machinery or equipment are rented by an enterprise, the payments of rentals under an operating lease or similar lease are recorded as purchases of services. These services form part of intermediate consumption. Thus, as explained in <<chapter VI, Production Account, paragraph>>, the payment of the rental on a fixed asset tends to reduce gross value added below what it would be if the producer owned the asset. The impact on net value added, however, is mitigated by the fact that a tenant, or lessee, incurs no consumption of fixed capital whereas an owner would. In general, however, even net value added will tend to be lower when a fixed asset is rented as the rental has to cover the lessor's operating and interest costs as well as the consumption of fixed capital. Thus, the net operating surplus/mixed income is not invariant to the extent to which fixed assets are rented rather than purchased. At the level of the total economy, however, the lower surpluses accruing to tenants or lessees will tend to be counterbalanced by the operating surpluses earned by the lessors.

85. It should also be noted that enterprises may invest surplus funds in financial assets or even land, especially in times of uncertainty and high interest rates. Considerable property income may be received from such investments. The property income paid out by a corporation will be influenced by the amount of property income received as well as by its operating surplus. Thus, it is not appropriate to record all the property income paid out by an enterprise as if it were chargeable against the operating surplus. Some interest costs, especially implicit costs, may be attributable to assets other than those used in production. For this reason, the explicit and implicit interest costs payable by an enterprise ought not to be recorded in the Generation of Income Account in which the resources consist only of value added accruing from production. They are recorded in the Allocation of Income Account after taking account of any property income receivable as well as the operating surplus.

1. Mixed income

86. As already noted the term "mixed income" is used to describe the balancing item in the Generation of Income Account for a sub-set of enterprises, namely unincorporated enterprises owned by members of households either individually or in partnership with others in which the owners, or other members of their households, may work without receiving a wage or salary. Owners of such enterprises must be self-employed: those with paid employees are employers, while those without paid employees are own-account workers. In a few cases, it may be possible to estimate the wage or salary element implicitly included within mixed income, but there is usually not enough information available about the number of hours worked or appropriate rates of remuneration for values to be imputed systematically. Thus, mixed income contains an unknown element of remuneration for work done by the owner of the enterprise, or other members of the same household, as well as the surplus accruing from production. The element of remuneration could be predominant in some cases.

87. A further difficulty with unincorporated enterprises is that it is often not possible to draw a clear distinction between the assets, including financial assets and liabilities, of an unincorporated enterprise and those of the owner in a personal capacity. Many fixed assets, such as buildings and vehicles, may be used partly for business purposes and partly for purposes of household final consumption. In addition, some goods ostensibly purchased for intermediate consumption may in fact be consumed by members of the household. Owners of enterprises may have an incentive to portray durable or non-durable goods used for final consumption as being used by the enterprise in order to reduce profits as reported to tax authorities. Even when there is no such incentive, owners may have genuine difficulty in separating their business expenditures or liabilities from their personal expenditures or liabilities. Thus, mixed incomes may be less reliable than the operating surpluses reported by corporations or government enterprises, and it may be useful to separate them for this reason also.

F. Property Incomes

1. Introduction

88. Property incomes are received by the owners of financial assets and tangible non-produced assets, mainly land and sub-soil assets. Property incomes accrue when the owners of such assets put them at the disposal of other institutional units. Institutional units with funds to invest do so by lending them to other units. As a result, financial assets are created whose owners are entitled to receive property incomes in the form of interest, dividends, etc. Owners of land and sub-soil assets may put them at the disposal of other units by arranging contracts or leases under which the tenants, or users of the assets, agree to pay the owners property incomes in the form of rents. The regular payments made by the lessees of sub-soil assets are often described as royalties, but they are treated as rents in the System. The term "rent" is reserved in this manual for rents on land and sub-soil assets, payments under operating leases being described as "rentals".

89. Property income may therefore be defined as:

> the income receivable by the owner of a financial asset or a tangible non-produced asset in return for providing funds to, or putting the tangible non-produced asset at the disposal of, another institutional unit.

The terms governing the payment of property incomes are usually specified in the financial instrument created when the funds are transferred from the creditor to the debtor or in the contract or lease signed when the right to exploit the land or sub-soil assets is transferred from the owner to the tenant or lessee. Such arrangements are typically made only for a limited period of time, after which the funds must be repaid or the right to exploit the land or sub-soil assets reverts to the owner. The period of time may be

several months or several years, and such arrangements may of course be renewed.

90. Property incomes are classified in the following way in the System:

Interest
Distributed income of corporations
  Dividends
  Withdrawals from income of quasi-corporations
Reinvested earnings on direct foreign investment
Property income attributed to insurance policy holders
Rent

Each of these items is described in more detail below. The income that the owners of quasi-corporations withdraw from them is analogous to the income withdrawn from corporations by paying out dividends to their shareholders. It is therefore treated as property income accruing to the owners of quasi-corporations.

2. Property incomes distinguished from rentals

91. The distinction between property incomes and the rentals receivable and payable under operating leases is fundamental to the System as rentals are treated as sales or purchases of services. The nature of operating leasing has already been described in <chapter VI, Production Account>. In the present context, it is sufficient to underline the differences between operating leasing and the renting of land and sub-soil assets.

(1) Under an operating lease, the items leased consist of fixed assets such as buildings, ships, aircraft, vehicles, etc. that are all produced assets.

(2) The lessors of produced assets are typically engaged in processes of production whereby they provide services to the lessees by purchasing and maintaining inventories of fixed assets that they are able to lease out at short notice and for varying lengths of time for the convenience of their clients.

(3) The lessors engage in gross fixed capital formation in order to acquire the assets and incur consumption of fixed capital in respect of the assets they lease.

92. The rentals payable by lessees to lessors are therefore treated as purchases of services produced by the latter. They may be recorded under the intermediate consumption of enterprises or under the final consumption of households or government. On the other hand, the owners of funds, land or sub-soil assets who merely place these assets at the disposal of other units are not considered to be themselves engaged in productive activity. The assets loaned, rented or leased have not been produced and no capital

consumption is incurred in respect of their use. The property incomes payable by enterprises that borrow funds or rent land or sub-soil assets do not affect the calculation of their value added or operating surpluses.

93. The renting of buildings, including dwellings, is not usually described as operating leasing, but the rentals paid by tenants under a building lease are treated in the same way as the rentals paid by lessees of other fixed assets. The rentals paid by tenants are treated as payments for the provision of building or housing services. Similarly, permitting other units to make use of intangible fixed assets in the form of originals is treated in the same way as operating leasing. Although the payments made by units using processes or producing products covered by patents are usually described as "royalties", they are treated as purchases of services produced by the owners of the patents.

3. Interest

a. Introduction

94. Interest is a form of property income that is receivable by the owners of certain kinds of financial assets: namely,

deposits
securities other than shares
loans
other accounts receivable

These financial assets are all claims of creditors over debtors. Creditors lend funds to debtors that lead to creation of one or other of the financial instruments listed above. The amount of the debtor's liability to the creditor at any point of time may be described as the principal outstanding. It is the amount that the debtor must repay to discharge the liability and thereby extinguish the creditor's claim over the debtor.

Interest may be defined as follows:

> Under the terms of the financial instrument agreed between them interest is the amount that the debtor becomes liable to pay to the creditor over a given period of time without reducing the amount of principal outstanding.

However, the interest may not necessarily be due for payment until a later date and sometimes not until the loan, or other financial instrument, matures. Interest may be a predetermined sum of money or percentage of the principal outstanding. If some or all of the interest accruing to the creditor is not paid during the period in question, it may be added to the amount of the principal outstanding or it may constitute an additional, separate liability incurred by the debtor. As explained in <chapter XI, Financial Account>,

there are many different kinds of financial instruments and new instruments are continually being evolved. Interest may therefore be paid in various different ways, not always explicitly described as interest.

(i) The full accrual basis of recording

95. Interest is recorded on a full accrual basis: that is, interest is recorded as accruing continuously over time to the creditor on the amount of principal outstanding. The interest accruing is the amount receivable by the creditor and payable by the debtor. It may differ not only from the amount of interest actually paid during a given period but also the amount due to be paid within the period. Some financial instruments are drawn up in such a way that the debtor is obliged to make regular interest payments, period by period, as the interest accrues but in other cases there may be not such a requirement.

96. Certain financial instruments, for example bills and zero coupon bonds, are such that the debtor is under no obligation to make any payments to the creditor until the asset matures. In effect, no interest becomes due for payment until the end of the asset's life at which point the debtor's liability is discharged by a single payment covering both the amount of the funds originally provided by the creditor and the interest accumulated over the entire life of the asset. However, in the System, the interest accruing in each accounting period must be recorded whether or not it is actually paid or left to add to the principal outstanding. When it is not paid, the increase in the principal must also be recorded in the Financial Account as a further acquisition of that kind of financial asset by the creditor and an equal acquisition of a liability by the debtor.

b. Interest on deposits, loans and accounts receivable and payable

97. The nature of financial assets and liabilities in the form of deposits, loans and accounts receivable and payable is explained in <chapter XI, Financial Account>. In general, the interest receivable and payable on these financial assets and liabilities is determined simply by applying the relevant rate of interest to the principal outstanding at each point of time throughout the accounting period.

c. Interest on securities

(i) Interest on bills and similar instruments

98. As explained in <chapter XI, Financial Account>, bills are short-term securities that give the holder (creditor) the unconditional right to receive a stated fixed sum on a specified date. They are issued and traded in organised markets at a discount that depends on current market short-term

interest rates and the time to maturity. Most bills mature after a period ranging from one month to one year.

99. Let the price paid for a bill at its time of issue be L: this represents the amount of funds that the purchaser (creditor) provides to the issuer (debtor) and measures the value of the initial liability incurred by the issuer. Let the face value of the bill be F: this represents the sum paid to the holder of the bill (the creditor) when it matures. The difference, F-L, or discount on the bill, measures the interest payable over the life of the bill.

100. Bills are traded on money markets at prices which gradually rise to reflect the interest accruing on the bills as they approach maturity. The increase in the price of a bill due to the accumulation of accrued interest does not constitute a holding gain because it forms part of the original contract between the issuer and purchaser of the bill.

(ii) Interest on bonds and debentures

101. Bonds and debentures are long term securities that give the holder the unconditional right to:

(1) a fixed or contractually determined variable money income in the form of coupon payments;

or

(2) a stated fixed sum on a specified date or dates when the security is redeemed;

or

(3) both (1) and (2). Most bonds fall into this category.

The amounts of the fixed or variable money incomes or coupon payments due for payment within the accounting period are treated as interest receivable and payable by the creditor and debtor respectively. In addition, when a bond is issued at a discount, the difference between the face value, or redemption price, and the issue price constitutes interest that accrues over the life of the bond, in the same way as for a bill. However, as accounts are compiled for time periods that are typically much shorter than the life of the bond, the interest must be distributed over those periods. They way in which this may be done is explained in the following section.

(a) Zero-coupon bonds

102. Zero-coupon bonds are long-term securities that are similar to bills. They do not entitle their holders to any fixed or variable money income but only to receive a stated fixed sum as repayment of principal and accrued interest on a specified date or dates. When they are issued they are usually sold at a price that is substantially lower than the price at which it is redeemed on maturity. Let L equal the issue price and F the redemption price, F-L is the value of the interest receivable and payable over the life of the bond. This interest has to be distributed over the years to its maturity. One possible method is to assume interest is credited at the end of each year at an annual rate that is constant over the life of the bond, in which case the rate is given by the following expression:

$$r = (F/L)^{1/n}-1$$

where n is the number of years from the time of issue to maturity. The interest accruing during the course of year t is then given by

$$rL(1+r)^{t-1}$$

where t = 1 at the end of the first year.

103. The interest accruing each year is effectively reinvested in the bond by its holder. Thus, a counterpart entry equal to the value of the accrued interest must be recorded in the Financial Account as an acquisition of a bond by the holder and as a further issue of a bond by the issuer or debtor.

(b) Other bonds, including deep-discounted bonds

104. Most bonds pay a fixed or variable money income and may also be issued at a discount or, possibly, a premium. In such cases, the interest receivable by the holders of the bonds has two components:

(1) the amount of the money income receivable from coupon payments each period;

plus

(2) the amount of interest accruing each period attributable to the difference between the redemption price and the issue price.

The second component is calculated in the same way as for zero-coupon bonds, as described in the previous section. In the case the deep-discounted bonds, the amounts of money income payable each period are relatively small and most of the interest accruing is attributable to the difference between the

redemption price and the issue price. At the other extreme, some bonds offer an income stream in perpetuity and are never redeemed.

105. When the market rate of interest on bonds of a particular type changes during the life of an existing bond, a discrete change occurs in the price at which that bond can be traded on markets. Such a price change leads to a nominal holding gain or loss for the holder and issuer of the bond. The price change also leads to a consequential change in the total amount of interest accruing on the bond over the period of time remaining to maturity, the new interest being equal to the difference between the redemption price and the market price of the bond after the interest rate change. The new interest should be distributed over the remaining accounting periods using the same method as that described above. This point is elaborated further in <<chapter XII, Other Changes in Assets Accounts, paragraphs>>, in which the measurement of holding gains and losses on financial assets and liabilities is explained. Similar holding gains and losses may accrue on bills as a result of changes in short-term interest rates, but they are likely to be less significant in practice because bills tend to have much shorter lives than bonds.

(c) Index linked securities

106. Index linked securities are financial instruments for which the amounts of the coupon payments (interest) and/or the principal outstanding are linked to a general price index, a specific price index or an exchange rate index. When the coupon payments are index linked, the full amounts of such payments are treated as interest receivable and payable, in the same way as the interest receivable and payable on any other security paying a contractually agreed variable income. When the value of the principal is index linked, the difference between the eventual redemption price and the issue price is treated as interest accruing over the life of the asset in the same way as for a security whose redemption price is fixed in advance. In practice, the change in the value of the principal outstanding between the beginning and end of a particular accounting period due to the movement in the relevant index may be treated as interest accruing in that period, in addition to any interest due for payment in that period. The interest accruing as a result of the indexation is effectively reinvested in the security and must be recorded in the financial accounts of the holder and issuer.

d. Interest rate swaps and forward rate agreements

107. Swaps are contractual arrangements between two institutional units who agree to exchange streams of payables on the same amount of indebtedness over time. Common varieties of swaps are interest rate swaps and currency swaps. Interest rate swaps consist of the exchange of interest payments of different character, for example:

- fixed rate payments for floating or variable rate payments,
- one kind of floating rate payments for another,

- fixed rate payments in one currency for floating rate payments in another currency,

and so on. The streams of interest payments resulting from swap arrangements should be recorded net of the payments between the two parties to the swap. Neither of the parties is treated as providing a service to the other, but any payments made to third parties, such as specialised brokers, for arranging the swaps are recorded as purchases of services.

108. The same principle is applied to transactions under forward rate agreements (FRAs). These are arrangements in which two parties, in order to protect themselves against interest rate changes, agree on an interest rate to be paid on a specified settlement date on a nominal amount of principal that is never exchanged. The only payment that takes place relates to the difference between the agreed FRA rate and the prevailing market rate on the settlement date. The buyer of the FRA receives payment from the seller if the prevailing rate exceeds the agreed rate, while the seller receives payment if the latter exceeds the former. These payments are recorded as interest receivable and payable.

e. Interest on financial leases

109. When a financial lease is negotiated, the fixed asset is deemed to be purchased by the lessee, instead of the lessor, out of funds provided by the latter. In the System, the lessor is treated as making a loan to the lessee equal to the value of the purchaser's price paid for the asset, this loan being gradually paid off in full over the period of the lease. The rental paid each period by the lessee is therefore treated as having two components: the first consists of a repayment of principal, the remainder being treated as a payment of interest. The rate of interest on the imputed loan is implicitly determined by the total amount paid in rentals over the life of the lease in relationship to the purchaser's price of the asset. It is easily calculated using standard tables or programmes. Assuming that the rental remains constant from period to period, the share of the rental that represents interest gradually declines over the life of the lease as the principal is repaid. The initial loan by the lessee, together with the subsequent repayments of principal, are recorded in the Financial Accounts of the lessor or lessee. The interest payments are recorded under interest in their respective Primary Distribution of Income Accounts.

f. Interest payable and receivable by financial intermediaries

110. The amounts of interest payable and receivable by financial intermediaries are set in order to provide a margin which is used to defray the costs of providing certain services to their customers, both depositors and borrowers, for which they do not charge explicitly. As explained in <chapter VI, Production Account>, the interest rates paid or charged to customers are generally fixed in relation to a particular reference rate such as the central bank rate, an interbank rate or other rate. Lending rates are

usually higher than the reference rate, while rates paid to depositors are usually lower than the reference rate.

111. The actual payments or receipts of interest to or from financial intermediaries need to be adjusted therefore to eliminate the margins that represent the charges for services provided by financial intermediaries for which no explicit charges are made. Thus, the amounts of interest paid by borrowers to financial intermediaries must be reduced to the levels that would be payable if the reference rate were charged, while the amounts of interest receivable by depositors must be increased to the levels that would be receivable if the reference rate were used. The differences between these amounts and the amounts actually paid and received are treated not as interest but as payments for services rendered by financial intermediaries to their customers. They are recorded as sales (output) of services in the Production Accounts of financial intermediaries and as intermediate or final expenditures (uses) in the accounts of their customers.

g. Nominal and real interest

112. When a debtor is able to discharge his liability to the creditor by repaying principal equal in money value to the funds borrowed the associated interest payments are described as "nominal". Such interest payments do not represent the "real" return to the creditor when the purchasing power of the funds repaid is less than that of the funds borrowed as a result of inflation. In situations of chronic inflation, therefore, the nominal interest payments demanded by creditors typically rise in order to compensate them for the losses of purchasing power that they expect when their funds are eventually repaid.

113. In inflationary situations, it is possible to view an actual payment of nominal interest as consisting of two components:

(1) a payment equal to the loss of purchasing power on the monetary value of the principal during the accounting period;

(2) the balance remaining that represents the real interest accruing to the creditor.

The first component may be calculated by multiplying the value of the principal by the change in some general price index. It may be regarded as a payment made by the debtor to compensate the creditor for the real holding loss on the principal outstanding. The remainder of the nominal interest payment, which could be positive or negative, constitutes real interest.

114. The interest recorded in the Allocation of Primary Income Account is the amount of nominal interest receivable or payable (plus, or minus, the charges for services for which no explicit charges are made, when relevant). Although the real holding losses incurred by creditors should be recorded in the Revaluation Account, they may not always be available in practice.

4. Distributed income of corporations

a. Dividends

115. Corporations obtain funds by issuing shares in their equity which entitle the holders to shares both of distributed profits and the residual value of the assets of the corporation in the event of its liquidation. Shareholders are the collective owners of a corporation.

116. Dividends are a form of property income to which shareholders become entitled as a result of placing funds at the disposal of corporations. Raising equity capital through the issue of shares is an alternative way of raising funds to borrowing. In contrast to loan capital, however, equity capital does not give rise to a liability that is fixed in monetary terms and it does not entitle the holders of shares of a corporation to a fixed or predetermined income.

117. Just as corporations are understood in the System to cover a set of institutional units engaged on production which may be described by different names - private or public corporations, private or public companies, co-operatives, limited liability partnerships, etc. - dividends must also be understood to cover all distributions of profits by corporations to their shareholders or owners, by whatever name they are called. Dividends may occasionally take the form of an issue of shares, but issues of bonus shares which represent the capitalisation of own funds in the form of reserves and undistributed profits are not included.

b. Withdrawals from income of quasi-corporations

118. Although a quasi-corporation is treated as if it were a corporation, it cannot distribute income by paying dividends to its owner. Nevertheless, the owner, or owners, of a quasi-corporation may choose to withdraw some or all of the entrepreneurial income of the enterprise. Conceptually, the withdrawal of such income is equivalent to the distribution of corporate income through dividends and is treated as if it were a type of dividend. It needs to be identified separately in order to be able to measure the income of the quasi-corporation, as distinct from that of its owner.

119. In order for an unincorporated enterprise to be treated as a quasi-corporation it must have a complete set of accounts of its own. It follows that any income withdrawn from a quasi-corporation should be explicitly identifiable in its accounts, where it is likely to be recorded as a payment, or transfer, to an account of the owner kept separately from the accounts relating to the activities of the quasi-corporation itself.

120. The amount of income which the owner of quasi-corporation chooses to withdraw will depend largely on the size of its entrepreneurial income: that

is, its operating surplus plus property income receivable on any assets owned by the enterprise minus any interest or rents payable on its liabilities, land or other tangible non-produced assets. When deciding exactly how much to withdraw, the owner has to take into account the size of its entrepreneurial income in much the same way as the board of directors of a corporation in deciding how much to pay out in dividends. Conceptually, the income withdrawn is a form of property income accruing the owner of a quasi-corporation in respect of funds invested in the enterprise.

121. Withdrawals of income from a quasi-corporation do not, of course, include withdrawals of funds realised by the sale or disposal of any assets owned by the quasi-corporation: for example, the sale of inventories, fixed assets or land or other non-produced assets. Such sales would be recorded as disposals in the Capital Account of the quasi-corporation and the transfer of the resulting funds would be recorded as a withdrawal from the equity of quasi-corporations in the Financial Accounts of the quasi-corporation and its owner(s). Similarly, funds withdrawn by liquidating large amounts of accumulated retained savings or other reserves of the quasi-corporation, including those built up out of provisions for consumption of fixed capital, are treated as withdrawals from equity. Conversely, any funds provided by the owner(s) of a quasi-corporation for the purpose of acquiring assets or reducing its liabilities should be treated as additions to its equity. Just as there cannot be a negative distribution from the entrepreneurial income of corporations in the form of negative dividends, it is not possible to have a negative distribution from the entrepreneurial income of quasi-corporations in the form of negative withdrawals. However, if the quasi-corporation is owned by government, and if it runs a persistent operating deficit as a matter of deliberate government economic and social policy, any regular transfers of funds into the enterprise made by government to cover its losses should be treated as subsidies, as explained in <<paragraph 77 (3)>>.

5. Reinvested earnings on direct foreign investment

122. As explained in <chapter >, a direct foreign investment enterprise is a corporate or unincorporated enterprise in which a foreign investor has made a direct foreign investment. A direct foreign investment enterprise may be:

either

(1) the (unincorporated) branch of a non-resident corporate or unincorporated enterprise: this is treated as a quasi-corporation;

or

(2) a corporation in which at least one foreign investor (which may, or may not, be another corporation) owns sufficient shares to have an effective voice in its management.

123. Actual distributions may be made out of the entrepreneurial income of direct foreign investment enterprises in the form of dividends or withdrawals of income from quasi-corporations. The payments made in these ways to foreign direct investors are recorded in the accounts of the SNA and in the balance of payments statistics of the IMF as international flows of property income. However, both systems also require the saving or retained earnings of a direct foreign investment enterprise to be treated as if they were distributed and remitted to foreign direct investors in proportion to their ownership of the equity of the enterprise and then reinvested by them. In other words, two additional entries are required in the accounts of the enterprises and their foreign owners, one of which is the imputed remittance of retained earnings while the second is the imputed reinvestment of those earnings. The imputed remittance of these retained earnings is classified in the System as a form of distributed income that is separate from, and additional to, any actual payments of dividends or withdrawals of income from quasi-corporations.

124. The rationale behind this treatment is that, since a direct foreign investment enterprise is, by definition, subject to control, or influence, by a foreign direct investor or investors, the decision to retain some of its earnings within the enterprise must represent a conscious deliberate investment decision on the part of the foreign direct investor(s). In practice, the great majority of direct investment enterprises are subsidiaries of foreign corporations or the unincorporated branches of foreign enterprises, i.e., quasi-corporations, that are completely controlled by their parent corporations or owners.

125. The retained earnings in question are equal to:

> the operating surplus of the direct foreign investment enterprise
>
> plus
>
> any property incomes or current transfers receivable,
>
> minus
>
> any property incomes or current transfers payable, including actual remittances to foreign direct investors and any current taxes payable on the income, wealth, etc. of the direct foreign investment enterprise.

Thus, the retained earnings are equal to the entrepreneurial income of the foreign direct investment enterprise plus or minus any current transfers receivable or payable, including any current taxes on income, wealth, etc. payable. If the direct enterprise is wholly owned by a single foreign direct investor (for example, a branch of a foreign enterprise) the whole of the retained earnings are deemed to be remitted to that investor and then reinvested. When a foreign direct investor owns only part of the equity of the direct investment enterprise, the amount which is deemed to be remitted

to, and reinvested by, the foreign investor is proportional to the share of the equity owned.

6. Property income attributed to insurance policy holders

126. Life insurance reserves consist of reserves against outstanding risks and reserves for with-profit insurance which add to the value on maturity of with-profits endowment or similar policies. Although held and managed by insurance enterprises, life insurance reserves are treated as assets that belong to the households of the insured persons, and they are not part of the net worth of the insurance enterprises. They are collectively described as the net equity of households on life insurance reserves. The reserves themselves may be invested in securities, land, or other assets from which property income is receivable. Such income must therefore be treated as accruing to the households that have taken out life insurance policies and not to the insurance enterprises that administer the reserves on their behalf.

127. The property income receivable from the investment of life insurance reserves must therefore be recorded as accruing to the households that have taken out the policies. The allocation of this income to households is achieved by recording:

(1) as a payable, an amount equal to the total value of this property income under uses in the Allocation of Primary Income Account of insurance enterprises,

and

(2) as receivables, amounts of equal combined value under resources in the Allocation of Primary Income Accounts of resident and non-resident households: that is, in the accounts for the household sector and the rest of the world.

Households are then treated as investing this income in the net equity of households on life insurance reserves, the addition to the net equity being recorded in the Financial Accounts of households and insurance enterprises.

Similarly, reserves held by pension funds are treated as assets that belong to households of persons with pension claims and not part of the net worth of the managers of the funds. Thus income from the investment of the reserves must be treated as accruing to the households that own the assets. The recording in the Allocation of Primary Income Account parallels that just described for life insurance. Households are then treated as investing this income in the net equity of households on pension funds, the addition to net equity being recorded in the Financial Accounts of households and pension funds.

7. Rents

a. Rents on land

128. The rent received by a landowner from a tenant constitutes a form of property income. Rent is recorded on a full accrual basis: that is, rent is treated as accruing continuously to the landowner throughout the period of the rental contract agreed between the landowner and the tenant. The rent recorded for a particular accounting period is therefore equal to the value of the accumulated rent payable over that period of time, as distinct from the amount of rent due to be paid during that period or the rent actually paid.

129. Rent may be paid in cash or in kind. Under share-cropping or similar schemes, the value of the rent payable is not fixed in advance in monetary terms and is measured by the value at basic prices of the crops that the tenants are obliged to provide to the landowner under the contract between them. Rents on land also include the rents payable to the owners of inland waters and rivers for the right to exploit such waters for recreational or other purposes, including fishing.

130. A landowner may be liable to pay land taxes or incur certain maintenance expenses solely as a consequence of owning the land. By convention, such taxes or expenses are treated as payable by the tenant who is deemed to deduct them from the rent that he would otherwise be obliged to pay to the landowner. Rent reduced in this way by taxes or other expenses for which the landowner is liable is described as "net rent". By adopting the convention that the tenant pays only the net rent, the taxes or expenses are recorded in the Production or Generation of Income Accounts of the tenant. This treatment does not change the income of the tenant. The convention avoids the necessity to create a notional enterprise for the landowner if the landowner is not already engaged in some other kind of productive activity.

131. As already noted, the rentals payable on buildings or other structures are treated as purchases of services. In practice, however, a single payment may cover both rent and rentals when an institutional unit rents land and any buildings situated on it in a single contract, or lease, in which the two kinds of payments are not differentiated from each other. For example, a farmer may rent a farmhouse, farm buildings and farmland in a contract in which only a single payment is required to cover all three. If there is no objective basis on which to split the payment between rent on land and rental on the buildings, it is recommended to treat the whole amount as rent when the value of the land is believed to exceed the value of the buildings on it and as a rental otherwise.

b. Rents on sub-soil assets

132. The ownership of sub-soil assets in the form of deposits of minerals or fossil fuels - coal, oil or natural gas - depends upon the way in which property rights are defined by law and also on international agreements in the case of deposits below international waters. In some cases, the assets may be owned by the owner of the ground below which the deposits are located but in other cases they may be owned by a local or central government unit.

133. The owners of the assets, whether private or government units, may grant leases to other institutional units permitting them to extract such deposits over a specified period of time in return for the payment of rents. These payments are often described as royalties, but they are essentially rents that accrue to owners of the assets in return for putting them at the disposal of other institutional units for specified periods of time and are treated as such in the System. The rents may take the form of periodic payments of fixed amounts, irrespective of the rate of extraction or, more likely, they may be a function of the quantity or volume of the asset extracted. Enterprises engaged in exploration may make payments to the owners of surface land in exchange for the right to make test drillings or investigate by other means the existence and location of sub-soil assets. Such payments are also to be treated as rents even though no extraction may take place.

TABLE VII.1 ACCOUNT II.1.1.: GENERATION OF INCOME ACCOUNT

15-Apr-92
06:52

USES							RESOURCES					
S.1 TOTAL ECONOMY	S.15 NON PROFIT INSTITUTIONS SERVING HOUSEHOLDS	S.14 HOUSEHOLDS	S.13 GENERAL GOVERNMENT	S.12 FINANCIAL CORPORATIONS	S.11 NON-FINANCIAL CORPORATIONS	TRANSACTIONS AND BALANCING ITEMS	S.11 NON-FINANCIAL CORPORATIONS	S.12 FINANCIAL CORPORATIONS	S.13 GENERAL GOVERNMENT	S.14 HOUSEHOLDS	S.15 NON PROFIT INSTITUTIONS SERVING HOUSEHOLDS	S.1 TOTAL ECONOMY
						B.1g Value added, gross/Gross domestic product (2)						
						B.1 Consumption of fixed capital						
						B.1n VALUE ADDED, NET/NET DOMESTIC PRODUCT						
						D.1 Compensation of employees						
						D.11 Wages and salaries						
						D.12 Employers' social contributions						
						D.121 Employers' actual social contributions						
						D.122 Employers' imputed social contributions						
						D.2 Taxes on production and imports						
						D.21 Taxes on products (1)						
						D.211 Value added type taxes (VAT)						
						D.212 Taxes and duties on imp. excl. VAT						
						D.2121 Import duties						
						D.2122 Taxes on imp. excl. VAT and duties						
						D.213 Export taxes						
						D.214 Taxes on products except VAT, import and export taxes						
						D.29 Other taxes on production						
						D.3 Subsidies (-)						
						D.31 Subsidies on products (-)						
						D.311 Import subsidies (-)						
						D.312 Export subsidies (-)						
						D.319 Other subsidies on products (-)						
						D.39 Other subsidies on production (-)						
						B.2g Operating surplus, gross						
						B.3g Mixed income, gross						
						B.2n OPERATING SURPLUS, NET						
						B.3n MIXED INCOME, NET						

(1) For the valuation of output and the resulting contents of the items "Taxes on Products" and "Taxes on Production and Imports", please refer to the paragraphs ..... in the text.

(2) Gross Domestic Product is equal to the sum of the value added of the institutional sectors plus taxes on products less subsidies. (line ...)

TABLE VII.2 ACCOUNT II.1.2.: ALLOCATION OF PRIMARY INCOME ACCOUNT

15-Apr-92
06:52

USES							RESOURCES					
S.1 TOTAL ECONOMY	S.15 NON PROFIT INSTITUTIONS SERVING HOUSEHOLDS	S.14 HOUSEHOLDS	S.13 GENERAL GOVERNMENT	S.12 FINANCIAL CORPORATIONS	S.11 NON-FINANCIAL CORPORATIONS	TRANSACTIONS AND BALANCING ITEMS	S.11 NON-FINANCIAL CORPORATIONS	S.12 FINANCIAL CORPORATIONS	S.13 GENERAL GOVERNMENT	S.14 HOUSEHOLDS	S.15 NON PROFIT INSTITUTIONS SERVING HOUSEHOLDS	S.1 TOTAL ECONOMY
						B.2g Operating surplus, gross						
						B.3g Mixed income, gross						
						B.2n OPERATING SURPLUS, NET						
						B.3n MIXED INCOME, NET						
						D.4 Property income						
						D.41 Interest						
						D.42 Distributed income of corporations						
						D.421 Dividends						
						D.422 Withdrawals from income of quasi-corp.						
						D.43 Reinvested earnings on direct foreign investment						
						D.44 Property income attributed to insurance policy holders						
						D.45 Rent						
						B.5g Balance of primary incomes, gross/National income, gross						
						B.5n BALANCE OF PRIMARY INCOMES, NET/NATIONAL INCOME, NET						

TABLE VII.3 PRIMARY DISTRIBUTION OF INCOME - IDENTIFICATION OF ENTREPRENEURIAL INCOME

15-Apr-92
06:52

USES

RESOURCES

ACCOUNTS	S.1 TOTAL ECONOMY	S.15 NON PROFIT INSTITUTIONS SERVING HOUSEHOLDS	S.14 HOUSEHOLDS	S.13 GENERAL GOVERNMENT	S.12 FINANCIAL CORPORATIONS	S.11 NON-FINANCIAL CORPORATIONS	TRANSACTIONS AND BALANCING ITEMS	S.11 NON-FINANCIAL CORPORATIONS	S.12 FINANCIAL CORPORATIONS	S.13 GENERAL GOVERNMENT	S.14 HOUSEHOLDS	S.15 NON PROFIT INSTITUTIONS SERVING HOUSEHOLDS	S.1 TOTAL ECONOMY	ACCOUNTS
							B.2g Operating surplus, gross							
							B.3g Mixed income, gross							
							B.2n OPERATING SURPLUS, NET							
							B.3n MIXED INCOME, NET							
II.1.2.1														II.1.2.1
ENTREPRE-							D.4 Property income (1)							ENTREPRE-
NEURIAL							D.41 Interest							NEURIAL
INCOME							D.42 Distributed income of corporations							INCOME
							D.421 Dividends							
							D.422 Withdrawals from income of quasi-corp.							
							D.43 Reinvested earnings on direct foreign investment							
							D.44 Property income attributed to insurance policy holders							
							D.45 Rent							
							B.4g Entrepreneurial income, gross							
							B.4n ENTREPRENEURIAL INCOME, NET							
							D.1 Compensation of employees							II.1.2.2
II.1.2.2							D.2 Taxes on production and imports							ALLOCATION
ALLOCATION							D.3 Subsidies (-)							OF OTHER
OF OTHER							D.4 Property income (1)							PRIMARY
PRIMARY							D.41 Interest							INCOME
INCOME							D.42 Distributed income of corporations							
							D.421 Dividends							
							D.422 Withdrawals from income of quasi-corp.							
							D.43 Reinvested earnings on direct foreign investment							
							D.44 Property income attributed to insurance policy holders							
							D.45 Rent							
							B.5g Balance of primary incomes, gross, National income, gross							
							B.5n BALANCE OF PRIMARY INCOMES, NET/NATIONAL INCOME, NET							

(1) For the distribution of Property income between the two subaccounts II.1.1. and II.1.2 please refer to paragraph .... in the text.